

DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 99-0329

Use Tax

For Tax Years 1995 through 1997

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superceded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Use Tax—Cost of Goods Sold

Authority: IC 6-8.1-5-1

Taxpayer protests imposition of use tax on twenty percent (20%) of the Cost of Goods Sold.

II. Tax Administration—Negligence Penalty

Authority: IC 6-8.1-5-4; 45 IAC 15-11-2

Taxpayer protests imposition of a ten percent (10%) negligence penalty.

STATEMENT OF FACTS

Taxpayer is an independent dealer of motor vehicles. The Indiana Department of Revenue conducted an audit for the tax years 1995 through 1997. As a result of that audit, the Department determined that taxpayer was using items in its inventory for business or personal purposes and assessed use tax on 20% of the Cost of Goods Sold (COGS). Taxpayer protests the imposition of use tax on the 20% of COGS and a ten percent (10%) negligence penalty. Further facts will be provided as required.

I. Use Tax—Cost of Goods Sold

DISCUSSION

Taxpayer protests the imposition of use tax on twenty percent (20%) of the Cost of Goods Sold (COGS) at taxpayer's business. IC 6-8.1-5-1(b) provides in relevant part:

The notice of proposed assessment is prima facie evidence that the department's claim for unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made.

The Department imposed use tax at the twenty percent rate after determining that, due to high inventory turnover and insufficient record keeping, it would be impossible to determine use tax assessments on an item-by-item basis.

The Department issued proposed use tax assessments based on the best information available. IC 6-8.1-5-1(a) provides in relevant part:

If the department reasonably believes that a person has not reported the proper amount of tax due, the department shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the department.

At the administrative hearing, taxpayer referred to the list of examples of taxable items in the audit report. Taxpayer provided documentation to support its claim that several of the examples were not taxable, either because sales tax had already been paid or the item was on consignment.

Taxpayer seeks to reduce the assessments based on the taxable status of individual items that may have been expensed through COGS, offering documentation and citing several statutes in support of its position. Taxpayer misunderstands the assessment method. The assessments were not based on an item-by-item basis. The Department assessed use tax on twenty percent (20%) of the COGS.

The Department used the best information available, the COGS reported by taxpayer on its federal tax returns, as provided in IC 6-8.1-5-1(a). Taxpayer's records and the documentation provided in the protest are insufficient to establish the taxable status of every item expensed in COGS. This lack of documentation renders it impossible for the Department to determine if the individual items referred to by taxpayer are part of the twenty percent (20%) of COGS the Department did assess use tax on, or the eighty percent (80%) the Department did not assess use tax on.

Similarly, taxpayer's argument that some items were being held on consignment, and so not taxpayer's use tax responsibility, misunderstands the assessment method. If an item were sold or held on consignment there would be no cost to taxpayer, and so it would not go into taxpayer's cost of goods sold. Therefore, if the items referred to by taxpayer were being held on consignment, there was no cost reflected in the COGS and no use tax was assessed on them.

The list of examples included with the audit report was intended only to provide examples, not an exhaustive list of items upon which the Department considered use tax due. Whether or not a particular item on the list was subject to use tax is irrelevant. The Department did not assess use tax on individual items. Taxpayer's argument that certain items were not subject to use tax does not apply to the Department's assessment method. The Department assessed use tax on twenty percent (20%) of taxpayer's COGS as taxpayer reported on its federal tax return, due to

insufficient record keeping and as provided in IC 6-8.1-5-1(a). Items held on consignment would not have been included in the COGS. Taxpayer has provided insufficient documentation to establish that the assessment of use tax on twenty percent of taxpayer's COGS is incorrect and so has not met its burden under IC 6-8.1-5-1(b).

FINDING

Taxpayer's protest is denied.

II. Tax Administration—Negligence Penalty

DISCUSSION

Taxpayer protests the imposition of a ten percent (10%) negligence penalty. Taxpayer requests that all penalties be waived as it has acted in good faith at all times, and any remaining assessments are not the result of any fraud, willful disregard of Indiana's tax laws, or negligence on the part of taxpayer. Negligence is defined by 45 IAC 15-11-2(b), which states:

"Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

45 IAC 15-11-2(c) states in part:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-2.1] if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

Also of relevance is IC 6-8.1-5-4, which states:

- (a) Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records. The records referred to in this subsection include all source documents necessary to determine the tax, including invoices, register tapes, receipts, and canceled checks.
- (b) A person must retain the books and records described in subsection (a), and any state or federal tax return that the person has filed:

- (1) for an unlimited period, if the person fails to file a return or receives notice from the department that the person has filed a suspected fraudulent return, or an unsigned or substantially blank return; or
- (2) in all other cases, for a period of at least three (3) years after the date the final payment of the particular liability was due, unless after an audit, the department consents to earlier destruction.

In addition, if the limitation on assessments provided in section 2 of this chapter is extended beyond three (3) years for a particular tax liability, the person must retain the books and records until the assessment period is over.

- (c) A person must allow inspection of the books and records and returns by the department or its authorized agents at all reasonable times.
- (d) A person must, on request by the department, furnish a copy of any federal returns that he has filed.

In this instance, taxpayer has not established that the assessments are incorrect. Not paying use tax that was due under 45 IAC 15-11-2(b) and not having the records available at the time of the audit in violation of IC 6-8.1-5-4 is treated as negligence under 45 IAC 15-11-2(b).

FINDING

Taxpayer's protest is denied.

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